

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NORTH CAROLINA

IN RE:)	Case No. A-B-88-10616
)	Chapter 7
THE D.O. THOMPSON COMPANY, d/b/a)	
The Thompson Company and d/b/a)	
D.O. Construction Company,)	
)	
Debtor.)	

MEMORANDUM OPINION AND ORDER

This matter is before the court for a determination of the extent of the lien of NCNB National Bank of North Carolina (hereinafter "NCNB") in proceeds from the sale of certain of the debtor's personal property in which NCNB claims a security interest. For the reasons discussed below, the court has concluded that the proceeds of the sale of "model home furnishings" is not subject to NCNB's security interest and that NCNB does have a security interest in the proceeds of the sale of certain other of the incidental items of personal property sold.

PROCEDURAL HISTORY

The debtor was a residential developer and builder in the Hendersonville, North Carolina, area. It filed for relief under Chapter 11 of the Bankruptcy Code in December 1988. At that time it had ceased all construction operations and planned to liquidate its personal property by auction and then sell its real estate interests by private negotiated sales over time. In February 1988 the case was converted to a Chapter 7 proceeding and a Trustee was appointed.

The Trustee conducted an auction sale of the debtor's personal property in mid-February 1988. Prior to the sale NCNB objected to the sale and use of the proceeds from the sale of any property in which it claimed a security interest. The objection to the sale was overruled, on the condition that the property sold be specifically identified and that the proceeds of the sale of any property in which NCNB claimed a security interest be held in escrow pending a later determination of the Trustee's and NCNB's respective rights to those funds. After an evidentiary hearing and consideration of the parties' briefs and arguments, this is that determination.

FACTS

A. Background Facts

The debtor was engaged in developing, constructing and selling residential single family and multi-family dwellings. Its general business plan was to finance the purchase of a tract of land, sub-divide it into lots, construct the infrastructure (water, sewer, roads, etc.), construct and furnish a "model home," and use that model home to sell lots on which it would construct the homes. The debtor's assets (much of which were encumbered) consisted of real estate (undeveloped lots and lots with homes in various stages of construction), construction equipment, construction materials, office equipment and furnishings, and furnishings located in model homes.

In January 1987 NCNB and the debtor entered into a security agreement, later properly perfected, pursuant to which NCNB was granted a security interest to secure a loan it had made to the

debtor in the sum of \$181,651.93. The security agreement described the collateral in which NCNB was granted a security interest as "all equipment, furniture and fixtures now owned or hereafter acquired by the debtor." Paragraph 2 of the security agreement provided that the "collateral shall be located at 1830 Asheville Highway, Hendersonville, Henderson (County), NC until such time as written consent to a change of location is obtained from the Bank." The address referred to was the debtor's company headquarters.

In April 1987 a UCC financing statement release (UCC-3) was filed with the North Carolina Secretary of State releasing the following collateral: "all building material and equipment now or hereafter delivered to debtor's Hidden Valley property... or stored with other supplies to be used in construction of the improvements on said property."

The model home furnishings located at the Hidden Valley Farms subdivision were commingled with other model home furnishings prior to the auction sale conducted by the Trustee. NCNB has stipulated that thirty percent of the model home furnishings had been located at Hidden Valley Farms and has agreed that it did not have a security interest in those furnishings.

B. The Parties' Contentions and Testimony

The Trustee contends that there was never a "meeting of the minds" of the debtor and NCNB to grant NCNB a security interest in the model home furnishings. The Trustee contends that the model home furnishings constitute neither "furniture" nor "equipment" as those terms are used in the security agreement.

Rather, the Trustee contends that the model home furnishings constitute "inventory" of the debtor.

NCNB contends that the security agreement is clear on its face and that parol evidence regarding the parties' intent is inadmissible. NCNB contends that the model home furnishings constitute either furniture or equipment, inasmuch as their primary purpose was to facilitate sales of homes in the subdivisions debtor developed.

At the hearing on these issues, D.O. Thompson, Jr. (hereinafter "Mr. Thompson"), president of the debtor, testified that he did not discuss model home furnishings with NCNB when the security agreement was negotiated and signed. At that time, the model home furnishings were already financed with another lender. In the last three years, the debtor developed seven subdivisions and had about ten model homes on display. Mr. Thompson testified that he had been furnishing model homes since 1981. While the model home furnishings were bought to facilitate the sale of homes in the subdivisions, Mr. Thompson testified that he sold off items all along and expected and attempted to sell all furniture from a model home because the furniture might not fit the next model home. He stated that he never sold a model home without selling some of the home's furnishings to a home buyer. While the debtor depreciated furnishings held for over a year, the debtor also bought and sold some items of furnishings within the same year. Mr. Thompson testified that he never requested NCNB's permission to sell items from the model home furnishings and never remitted any proceeds from such sales to NCNB.

Roger Capps, the debtor's former Sales Manager and Vice President for Sales also testified for the Trustee. Mr. Capps' duties included overseeing the model homes and sales of both the model homes and other houses. He testified that he sold model home furnishings whenever there was an interested buyer and that with each sale of a model home he sold at least some of the furnishings. Mr. Capps stated that everything in a model home was for sale. Mr. Capps also testified that he did not know whether or not sales tax had ever been collected from the sales of items in model homes.

Ron Garland, a loan officer in NCNB's Hendersonville office, testified that the January 1987 security agreement represented the consolidation of previous loans to provide the debtor with a better payment schedule. Mr. Garland testified that, at the time the security agreement was entered into, Mr. Thompson had given the bank a listing of equipment and Mr. Garland's understanding was that NCNB's collateral included all items on the list that "did not have a motor" (and thus be subject to NC Certificate of Title/Motor Vehicle laws). Mr. Garland identified the list given the bank titled "Plant, Property and Equipment" and dated December 31, 1986. (Defendant's Exhibit 8). It includes "Model Furniture" as well as "Construction Equipment," "Office Equipment," "Office Furniture and Fixtures," and "Sales Trailer." Mr. Garland testified that he and Mr. Thompson had never discussed model home furnishings; that he and Mr. Thompson had "never gotten into specifics" about the collateral; and that he "assumed" that everything except automobiles and trucks was

included in NCNB's collateral. Danny Dowell, Mr. Garland's supervisor at NCNB, also testified that he understood the bank's collateral to include the items on list he said Mr. Thompson showed him, which he identified as the "Plant, Property and Equipment" list.

In rebuttal, Mr. Thompson testified that he did not deliver the Plant, Property and Equipment list to NCNB in January 1987, because it was a year-end 1986 statement which was not prepared until the following April or May, 1987. Mr. Thompson testified that he first delivered the list to NCNB in early 1988 after they had demanded payment on the then defaulted note.

DISCUSSION

The major issues that the parties have raised are (A) the propriety of considering parol evidence, (B) whether there was any agreement about a security interest in model home furnishings and (C) whether model home furnishings are "inventory" or "equipment." These are discussed seriatim:

A. Consideration of Parol Evidence

The security agreement is not so clear on its face that parol evidence regarding the intent of the parties is therefore inadmissible. Parol evidence is incompetent when contrary to the intent expressed in the instrument itself under a proper interpretation. Root v. Allstate Insurance, 272 N.C. 580, 158 S.E.2d 829 (1968). However, here that is not the case. The phrase "All equipment, furniture and fixtures now owned or hereafter acquired by debtor" is ambiguous in the context of this case. The debtor owned both office furniture and model home furniture and other

"furnishings." According to the Trustee's Report of sale, the— debtor owned model home furnishings beside "furniture," including clocks, mirrors, andirons, glasses, dishes, and the like. If NCNB meant to assert a lien on all model home furnishings, the word "furniture" is inadequate. Since the debtor also owned office furniture, the word "furniture" is ambiguous on that account also. Therefore, NCNB's contention that the model home furnishings are included in the term "furniture" in the security agreement, without more, must fail.

Additionally, if the security agreement were to include model home furnishings, then the requirement of its paragraph 2 that the collateral be located at the debtor's headquarters "until such time as a written consent to a change of location is obtained from the Bank" would not make sense. Since model home furnishings are obviously placed in the model home that provision has no meaning as to that purported collateral. (There was no evidence that a "written consent to a change of location" had ever been sought or executed).

Parol evidence may be admitted to interpret an ambiguous writing. Two of the country's premier authorities on the Uniform Commercial Code have stated that

the court must first resolve, as a question of law, whether the language embodied in the writing objectively indicates that the parties may have intended to create or provide for a security interest. If the language crosses this objective threshold, that is, if the writing evidences a possible secured transaction and thus satisfies the statute of frauds requirement, then the fact finder must inquire whether the parties actually intended to create a security interest (in certain collateral). Parol evidence is admissible to inform the latter but not the former inquiry.

White and Summers, Handbook of the Law under the Uniform Commercial Code, Section 23-3 (1980). Therefore, the court concludes that the security agreement is not clear on its face and that testimony was admissible to show the intent of the parties.

B. Agreement Regarding Collateral

In order for a lender to acquire a security interest in property of the debtor there must be an agreement to that effect. N.C. Gen. Stat. § 25-9-203, Amended Official Comment, Para. 1; Semco Division Delwood Furniture Company v. Williams (In re Metzler), 405 F. Supp. 622 (N.D. Ala. 1975). The court finds from the evidence offered here that there was no such agreement for transfer of a security interest in model home furnishings by the debtor to NCNB in this case.

The court finds plausible Mr. Thompson's testimony that the "Plant, Property and Equipment List," which is a detailed year end list compiled as part of the company's year end accounting, would not have been completed by mid-January 1987. In addition, the court finds plausible Mr. Thompson's testimony that he had not intended to include model home furnishings under the security agreement because it was already financed by another lender. This is supported by Mr. Garland's testimony that he and Mr. Thompson had never discussed furnishings. It is further confirmed by NCNB's lack of vigilance about this asserted collateral. Although Mr. Garland knew that model home furnishings were being sold by the debtor, he never did anything to monitor that or to claim the proceeds of those sales of NCNB's purported collateral.

-- even though the loan was in trouble (if not in default) during this time. So, NCNB's own actions confirm the absence of any agreement to create a security interest in model home furnishings.

Therefore, the court concludes that there was no agreement with regard to whether the model home furnishings were included in the property subject to NCNB's security interest. Consequently, NCNB is not entitled to the proceeds of the Trustee's sale of those items.

B. "Equipment" v. "Inventory"

There is an additional reason that the model home furnishings are not covered by NCNB's security agreement. In the context of this case, the model home furnishings constitute "inventory" of the debtor, and not "equipment."

Correct classification of goods has been an often litigated issue. See Annot., 77 ALR 3d 1266. Under the Uniform Commercial Code, "goods" are "equipment if they are used...primarily in business...or if the goods are not included in the definition of inventory, farm products or consumer goods." N.C. Gen. Stat. § 25-9-109(2). Goods are "inventory if they are held by a person who holds them for sale or lease...or if they are raw materials, work in process or materials used or consumed in a business. Inventory of a person is not to be classified as his equipment." N.C. Gen. Stat. § 25-9-109(4).

The Amended Official Comment to § 25-9-109 attempts to provide further guidance in differentiating between "inventory" and "equipment" as follows:

2. The classes of goods are mutually exclusive; the same property cannot at the same time and as to the same person be both equipment and inventory... In borderline cases...the principal use to which the property is put should be considered as determinative....
3. The principal test to determine whether goods are inventory is that they are held for immediate or ultimate sale. Implicit in the definition is the criterion that the prospective sale is in the ordinary course of business. Machinery used in manufacturing, for example, is equipment and not inventory even though it is the continuing policy of the enterprise to sell machinery when it becomes obsolete.... In general it may be said that goods used in a business are equipment when they are fixed assets or have, as identifiable units, a relatively long period of use; but are inventory, even though not held for sale, if they are used up or consumed in a short period of time in the production of some end product.
5. The principal definition of equipment is a negative one" goods used in a business...which are not inventory and not farm products.... It will be noted furthermore that any goods which are not covered by one of the other definitions in this section are to be treated as equipment.

As an initial matter, the fact that debtor included the model home furnishings in its "Plant, Property and Equipment" list does not determine the actual use of the items, nor do the debtor's bookkeeping and accounting practices with regard to depreciation and sales tax. See In Matter of Video Group, Inc., 1 B.R. 624 (Bankr. E.D. Mich. 1979). Bank One of Akron, NA v. Farmers Production Credit of Ashland, 39 U.C.C. Rep. 1511 (Bankr. N.D. Ohio 1984). The debtor's categorization of this property for accounting and tax purposes does not control -- or necessarily even impact -- its actual commercial categorization pursuant to the Uniform Commercial Code.

This is a close case involving unique facts, and the UCC, comments and cases offer little guidance as to the proper resolution of this issue.

Mr. Thompson testified that the model home furnishings were bought to facilitate the sale of homes. That would buttress an argument that the furnishings constitute "equipment," under the "primary purpose" test in the Amended Official Comment quoted above. On the other hand, the model home furnishings were treated differently from the machinery example in the UCC Amended Official Comment. Unlike machinery used in manufacturing and sold only when obsolete, Mr. Thompson and Mr. Capps both testified that everything in a model home was always for sale, and that items were sold any time someone was interested in buying. The set of furnishings was not static; items were acquired and sold within the course of a year. Thus, they were largely not "fixed assets" or "identifiable units" with a "relatively long period of use." Rather, they were "consumed" -- and regularly sold -- "in the production of some end product" here the sale of lots, homes and the model homes and furnishings themselves. The evidence thus shows that sales of model home furnishings were contemplated in the ordinary course of business. The "principal test" of "inventory" is that the "goods are held for immediate or ultimate sale." That was the case here for the model home furnishings.

The conclusion that the model home furnishings were "inventory" is supported by analysis which approaches the issue from a different direction. N.C. Gen. Stat. §§ 25-1-201(9) and

25-9-307(1) are worded so that only buyers of goods that are "inventory" in the hands of the seller can take the goods free of security interests. To qualify as a buyer in the ordinary course of business, a purchaser must buy goods from a person in the business of selling goods of that kind. If a person is in the business of selling goods, the goods that he holds for sale are necessarily "inventory" under N.C. Gen. Stat. § 25-9-109(4), (with the exception of farm products inapplicable in this case). See, e.g., United States v. Handy & Harman, 750 F.2d 777, 39 UCC Rep. 1553 (9th Cir. 1984). Certainly the the people who bought these furnishings must have believed that they were buying the model home furnishings from the debtor in the ordinary course of business, and never suspected the possibility that NCNB might much later assert a lien on the lamps, cookware, chairs and other items that they purchased. NCNB knew these sales were occurring, but never did anything to advise consumers of their purported lien or to trace their purported security. Consequently, the result reached here is consistent with the parties' actions and with fairness to innocent third parties.

The court finds that the debtor regularly sold model home furnishings in the normal course of its business of residential development and home construction. Therefore, the court concludes that the model home furnishings constitute "inventory" under N.C. Gen. Stat. § 25-9-109(4). Consequently, the proceeds from the Trustee's sale of those model home furnishings are not subject to NCNB's lien.

INCIDENTAL ITEMS

A number of incidental items of the debtor's property were sold at the Trustee's auction that were subject to dispute between NCNB and the Trustee.

The following items were sold for the amounts indicated and were designated in the Trustee's Report as part of "NCNB Collateral":

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>AMOUNT</u>
3214	File Cabinet	\$ 45.00
3230	Copier	500.00
3231	Typewriter	250.00 (1 of 2)
3258	2-Drawer Desk	77.50 (1 of 2)
3288	Chair	40.00
3624	Typing Table	12.50 (1/2 pkg.)
TOTAL AMOUNT		\$ 925.00

However, according to the agreement of the parties and Mr. Thompson's testimony, those items were located at the Hidden Valley Farms subdivision, and NCNB had released its security interest in that property. Consequently, those proceeds are property of the estate not subject to NCNB's security interest.

The following items were sold for the amounts indicated and designated in the Trustee's Report as the debtor's "inventory":

<u>ITEM</u>	<u>DESCRIPTION</u>	<u>AMOUNT</u>
3121	Gas Log	\$ 110.00 (1 of 2)
3126	2 Ready Heaters	120.00 (1 of 2)
3128	Ready Heater	32.50 (1 of 2)
3160	Air Conditioner	145.00
3164	Lot of Shelves	135.00
3188	Scaffolding	250.00
3506-3514		170.00 (2/3's of total)
3528	Oil Tank	\$ 125.00
3651-A	Shelves	300.00
3652	Shelves	175.00
3653		37.50 (1/2 pkg.)
TOTAL		\$ 1,590.00

However, according to the parties' agreement and Mr. Thompson's testimony, those items were not inventory, but were subject to NCNB's security interest. Consequently, those proceeds should be the property of NCNB.

It is therefore ORDERED that:

1. The proceeds from the sales of model home furnishings are not subject to the security interest of NCNB, but are unencumbered property of the debtor's estate;
2. The amount of \$ 925.00 shown in the Trustee's Report as subject to NCNB's security interest is unencumbered property of the debtor's estate;
3. The amount of \$ 1,590.00 shown in the Trustee's Report as inventory of the debtor is subject to NCNB's security interest; and
4. With the modifications noted above, the Report of Trustee on Results of Auction Sale is approved; and
5. The Trustee shall forthwith prepare an Amended Report of Trustee on Results of Auction Sale consistent with this Order and distribute the proceeds (those not escrowed pending other litigation) in accordance with that Amended Report.

This the 17th day of March, 1989.



George R. Hodges
United States Bankruptcy Judge

IN THE DISTRICT COURT OF THE UNITED STATES
FOR THE WESTERN DISTRICT OF NORTH CAROLINA

ASHEVILLE DIVISION

IN RE:

THE D. O. THOMPSON COMPANY, d/b/a
THE THOMPSON COMPANY and d/b/a
D. O. CONSTRUCTION COMPANY,
I.D. No.: 56-1238666,

Debtor.

NCNB NATIONAL BANK OF NORTH CAROLINA,

Movant,

v.

LANGDON M. COOPER, Trustee in
Bankruptcy for THE D. O. THOMPSON COMPANY,

Respondent.

) District Court Case: A-C-89-69
) Bankruptcy No.: A-B-88-10616

) MEMORANDUM AND ORDER

FILED

MAR 09 1990

ASHEVILLE, N. C.
U. S. DISTRICT COURT
WESTERN DISTRICT OF N.C.

THIS MATTER is before the Court pursuant to an appeal from the March 17, 1989 Memorandum and Order entered by the Honorable George R. Hodges, United States Bankruptcy Judge for the Western District of North Carolina, pursuant to Title 28 U.S.C.A. Section 158(a). The Court heard arguments of counsel for both the Appellant and Appellee in Asheville, North Carolina, on February 13, 1990. After careful consideration of the record on appeal, the briefs, arguments of counsel, and all of the pleadings heretofore filed in this case, the Court now enters its findings and conclusions.

The D. O. Thompson Company (hereinafter referred to as the "Debtor") filed a voluntary petition for bankruptcy under the provisions of Chapter 11 of the United States Bankruptcy Code on December 13, 1988. Debtor's case was converted to a Chapter 7 case on February 8, 1989 and Langdon M. Cooper was subsequently appointed Trustee and continues to serve in that capacity.

On February 11, 1989, a public auction sale was conducted by the Trustee at which all of the Debtor's tangible personal property was sold pursuant to Bankruptcy Court order. Pursuant to said order, valid perfected liens and security interests attached to the proceeds of the sale. On February 21, 1989, the Trustee filed a "Report of Trustee on Results of Auction Sale" which classified \$44,445 as proceeds from the sale of model home furnishings. The Trustee deemed the funds to be proceeds to which he was entitled and to which the lien of Appellant did not attach.

On February 23, 1989, an evidentiary hearing was conducted by the Bankruptcy Court to determine whether Appellant bank had a security interest in the model home furnishings. Appellant asserted it had a valid perfected security interest in seventy per cent (70%) of the model home furnishings and was thus entitled to 70% of the proceeds of their sale or \$31,112. The Trustee maintained that the Appellant never had a security interest in the Debtor's model home furnishings and that the Chapter 7 estate of the Debtor was entitled to the entire \$44,445.

On March 17, 1989, the Bankruptcy Court entered its "Memorandum Opinion and Order" holding that the proceeds from the sale of model home furnishings were not subject to any security interest held by Appellant and that it was not entitled to any of the \$44,445 proceeds of sale. Appellant bank filed notice of appeal to this Court on March 24, 1989.

The Bankruptcy Court's findings of fact are subject to the clearly erroneous standard of review and its conclusions of law are subject to de novo review by this Court. The issues thus before this Court are as follows:

1. Did the Bankruptcy Court err in considering parol evidence to determine the intent of the parties as to what specific collateral was covered by the language of the security agreement and UCC financing statements;

- 2 Were the Bankruptcy Court's findings of fact clearly erroneous; and
3. Were the Debtor's model home furnishings "inventory" or "equipment" as those terms are defined in the Uniform Commercial Code (UCC)?

The parties essentially are in agreement as to the issues just listed by the Court. Should the Court agree with the Bankruptcy Court that parol evidence was admissible and find that the resulting findings of fact are not clearly erroneous, the Court would not reach the question of whether the furnishings were "inventory" or "equipment" as that question would become moot if the parties did not intend for the furnishings to be security in the first place.

The following facts are essential to an understanding of how this controversy arose. The Debtor was a residential developer and builder in the Hendersonville, North Carolina, area. On January 15, 1987, Appellant and Debtor Appellee entered a "Security Agreement" wherein Appellant was granted a security interest to secure two prior loans it had made to the Debtor. At the time, Debtor owed Appellant bank a total of \$181,651.93. One note was secured, the other was not. Both were then due and owing. The January 15, 1987 loan consolidation was effected to provide for the cross-collateralization of both notes. The note already secured was secured by the Debtor's equipment, furniture, and fixtures. The Security Agreement described the collateral in which Appellant was granted a security interest specifically as "all equipment, furniture, and fixtures now owned or hereafter acquired by the Debtor." Paragraph two (2) of said agreement provided that the "collateral shall be located at 1830 Asheville Highway, Hendersonville, Henderson County, North Carolina until such time as written consent to a change of location is obtained from the bank." The Debtor's company headquarters were located at 1830 Asheville Highway. The model home

furnishings were not located at this address, but rather at the various model home sites.

On January 15, 1987, the single note, security agreement, and two UCC Financing Statements were signed by D. O. Thompson granting the same collateral as mentioned supra. The financing statements were subsequently filed by Appellant in the office of the North Carolina Secretary of State and in the office of the Henderson County Register of Deeds on January 19 and 20, 1987 respectively.

In September, 1987, the Debtor requested that NCNB postpone several payments. Debtor executed an Estoppel and Modification Agreement reaffirming the debt which recited "all other terms and conditions remain the same."

In March, 1988, the Debtor went into default under the note. Appellant made demand for immediate payment of the note. In addition, Appellant requested to see their collateral. In response, D. O. Thompson sent the bank a copy of a document entitled "Plant, Property, and Equipment." The document contained the model home furnishings on the last page. Thus the controversy over whether the model home furnishings were to be included as collateral was born.

In April, 1987, a UCC financing statement release was filed with the North Carolina Secretary of State wherein the following collateral was released: "all building material and equipment now or hereafter delivered to debtor's Hidden Valley property . . . or stored with other supplies to be used in construction of the improvements on said property."

Model home furnishings located at the Hidden Valley property were commingled with other model home furnishings prior to the auction sale. Appellant stipulated approximately thirty per cent (30%) of the model home furnishings had been located at Hidden Valley and therefore, it is only

claiming a security interest in seventy per cent (70%) of the model furnishings or \$31,112.

The Court will first address whether parol evidence was properly heard by the Bankruptcy Court and considered in its decision. For the reasons that follow, the Court agrees with the Bankruptcy Court's decision to allow and consider parol evidence.

The North Carolina Supreme Court has held that where a contract is unambiguous, parol evidence is inadmissible to explain, add to, or vary said contract. Bost v. Bost, 234 N.C. 554, 67 S.E.2d 745 (1951). Appellant would contend that to allow parol evidence in the case at bar would do just that; contradict the plain intent of the parties. In furtherance of its argument, Appellant cites N.C.G.S. 25-2-202, which actually relaxes somewhat the general rule expressed in Bost, supra. That section reads:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented

- (a) by a course of dealing or usage of trade (G.S. 25-1-208) or by course of performance (G.S. 25-2-208); and
- (b) by evidence of consistent additional terms unless the Court finds the writing to have been intended as a complete and exclusive statement of the terms of the agreement.

N.C.G.S. 25-2-202.

Appellee argues that the above section pertains particularly to Article 2 of the UCC on sales as opposed to Article 9 which deals with secured transactions. In any event, 25-2-202 does essentially express the modern parol evidence rule. Subsection (b) is particularly important, specifically the language which limits explanatory parol evidence where the Court finds the writing to have been intended as a complete and exclusive agreement. The

Bankruptcy Court held it not to be due to certain ambiguities in the security agreement and this Court agrees.

The security agreement clearly states that collateral shall be "all equipment, furniture and fixtures now owned or hereafter acquired by Debtor." However, just what is included as "furniture" is not so clear. In the Court's opinion, "furniture" does not necessarily fully encompass "furnishings," a point stressed by the Bankruptcy Court. The Trustee's Report of Sale indicates that the model home furnishings sold included items such as clocks, mirrors, glasses and dishes. Certainly these items are not generally considered "furniture" yet under Appellant's reasoning they would be included. Of course model home furniture was sold as well as office furniture. The point is, "furniture" in this context is ambiguous. Clearly the Bankruptcy Court recognized this ambiguity and the parties themselves still can not agree as to what is meant.

The second point the Court would make is that the security agreement in paragraph two (2) includes a requirement that the collateral be located at the Debtor's headquarters "until such time as a written consent to a change of location is obtained from the Bank." The Bankruptcy Court made the point that if the security agreement were to include model home furnishings, then the above requirement would not make sense as the furnishings are spread out all over the place in the various model homes. Said point is well taken. This fact adds to the ambiguity of the security agreement and is further evidence of the need for parol evidence to determine if there was indeed a meeting of the minds as to whether model home furnishings were to be included as collateral.

To allow parol evidence in the case at bar would be consistent with the case law. The North Carolina Supreme Court has held the introduction of

parol evidence to be proper where the writing at issue was not a complete and exclusive statement of the terms of the agreement. Performance Motors, Inc. v. Allen, 280 N.C. 385, 186 S.E.2d 161 (1972). It has also been held that:

[A]lthough a broad description may be appropriate when the subject matter has but one purpose or is easily identified, the same description is insufficient when the subject matter could have many purposes, or could be confused with other property not subject to the lien of the security agreement.

In Re Niles, 72 B.R. 84, 86 (Bank. N.D.Ill. 1987). The Court could cite as many cases as it cared to write about to support its opinion that parol evidence is admissible in situations where there is an ambiguity as to a key term in the agreement. In the case at bar there is such an ambiguity as to a key term, "furniture," and as such, the Bankruptcy Court did not err in admitting and considering parol evidence.

The Court will now address the issue of whether or not the Bankruptcy Court's findings of fact are clearly erroneous. The Bankruptcy Court found from the evidence before it that there was no "agreement for transfer of a security interest in model home furnishings by the debtor to NCNB in this case." (Memorandum Opinion and Order p. 8). After a review of the evidence, the Court is of the opinion that the Bankruptcy Court's decision is supported by the evidence and passes the clearly erroneous test for the reasons that follow.

North Carolina General Statutes 25-9-203, amended official comment reads: "1. Subsection (1) states three basic prerequisites to the existence of a security interest: agreement, value, and collateral." See N.C.G.S. 25-9-203(1). Appellee contends that one of these three, "agreement," is missing in this case. The Court agrees.

The Bankruptcy Court relied in part on Semco Division Delwood Furniture Company v. Williams, (In re Metzler), 405 F.Supp. 622 (N.D. Ala.

1975). There the Court stated:

It is fundamental that the Alabama Uniform Commercial Code deals with contractual or consensual liens, which can only be created by agreement of the parties. . . . The fundamental requirement of meeting of the minds is inherent in such agreements, as in all contracts.

Id. at 625. (citations omitted)

Metzler involved a security agreement with a similar ambiguity as the one in the case at bar. "All machinery, equipment and inventory maintained in the conduct of the debtor's business, . . . " Id. at 623 (emphasis in original). The Bankruptcy Court relied heavily on parol evidence in finding that no agreement existed as to certain property in a retail store owned by debtor. The District Court affirmed. Id. at 625.

The evidence of record in this case also tends to substantiate the Trustee's argument that there simply was no agreement as to the model home furnishings being collateral.

Ron Garland, a NCNB loan officer, testified that at the time of the restructuring in January, 1987, that no new collateral was required. He further testified that model home furnishings were never discussed. He testified that, at the time the security agreement was entered into, Mr. Thompson had given the bank a listing of equipment and Mr. Garland's understanding was that everything on the list was included that did not have a motor. Mr. Garland identified the list as the "Plant, Property and Equipment" list dated December 31, 1986. "Model furniture" was included on the list as well as "Construction Equipment," "Office Equipment," "Office Furniture and Fixtures" and "Sales Trailer." He further testified that he "assumed" everything except motor vehicles were included as collateral. Danny Dowell, Mr. Garland's supervisor at NCNB, essentially corroborated this testimony.

Mr. Thompson, President of Debtor, testified that he did not deliver

this list in January, 1987, because it was a year-end statement for 1986 which was not prepared until April or May, 1987. He testified that the first time the list was delivered was upon Appellant bank's demand to see their collateral in early 1988 after they had demanded payment on the note. At that time the list was delivered but not intended to be a listing of collateral but rather a Plant, Property and Equipment list which included Appellant's collateral. He testified that the model home furnishings were never discussed, and that they were in fact already financed with another lender. In support of the Trustee's contention that the furnishings were inventory rather than equipment, Mr. Thompson testified that while the furnishings were bought to facilitate the sale of homes, that he sold off furnishings all along and attempted to do so. According to Mr. Thompson, no model home was ever sold that did not include at least some of the furnishings. Furnishings held for over a year were depreciated, however, many items were bought and sold within the same year. Mr. Thompson testified that all this activity was without any discussion with, or permission from, Appellant and no funds from the sale of furnishings were ever forwarded to Appellant. Roger Capps, Debtor's former sales manager, essentially corroborated Mr. Thompson's testimony.

Appellant places great weight on the Plant, Property and Equipment list delivered to them in March, 1988, and perhaps in January, 1987. Mr. Thompson testified that NCNB "wanted to know what they had for collateral because they said they did not have a list. So I took a copy down there. Actually someone else took it down there, but I sent it from my desk merely to give them an idea because I knew it had to be on that list somewhere, what they had" (Rec. 80).

Mr. Thompson testified that it was never his intent to give Appellant

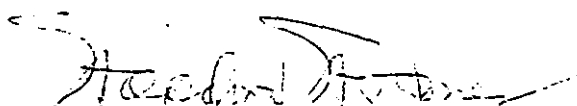
the model home furnishings as collateral (Rec. 56). The Bankruptcy Court noted that Mr. Garland's lack of vigilance in asserting any interest in the furnishings despite knowledge that they were constantly being sold, only confirmed the absence of an agreement to create a security interest in the model home furnishings. This Court agrees.

The Court does not need to reach the third issue regarding whether, under the UCC, the model home furnishings would be "inventory" or "equipment." The Bankruptcy Court entertained the question and found the furnishings to be inventory, apparently as an alternative ground for ruling for the Trustee. In any event, based on its decision on the first two issues, a finding of the furnishings to be inventory is essentially implicit. Due to the fact that this Court agrees with the Bankruptcy Court that parol evidence was admissible and that the decision was not clearly erroneous, the Court's inquiry need go no further.

Based on an independent review of the evidence, the Court cannot say that the Bankruptcy Court's decision was clearly erroneous. There was conflicting evidence. The judge heard and weighed the evidence and there is ample support in the record for his decision.

IT IS THEREFORE ORDERED that the "Memorandum Opinion and Order" entered by the Bankruptcy Court be and the same is hereby affirmed.

This the 2nd day of March, 1990.


United States District Judge